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Executive Control as Applied to Cost Reduction

By J. W. CONRAD

Manager, Rockford Office

The general business slump of the past year and the accompanying decline in sales volume has forcibly brought home to executives the importance of efficiency in business. The result has been that business thought is now being directed not so much toward expanding as to making the most economical use of present personnel, plant facilities and working capital. If periods of subnormal production such as we are now experiencing accomplish nothing else, they develop in the management a critical policy with respect to expenditures and a realization that profit maintainence in periods of declining sales usually necessitates a corresponding reduction in the cost of doing business. Let us consider then some of the more effective measures which have been adopted by progressive managements to bring about this necessitous cost reduction.

Labor

Business executives today recognize the fact that their investment in man power is just as truly an asset as are security holdings and in many respects the former is the more difficult to replace. For that reason many operating heads adopted the policy of shorter working periods, reduced rates of pay and the like to avoid resorting to wholesale dismissal of employees. One manufacturer in the middle west recently discontinued the preparation of several reports summarizing and comparing salesmen's traveling expenses, customer calls, etc. and used part of the clerical personnel so employed in the compilation of statistics showing possible new outlets for his product. Another alert superintendent after a careful study of possible duplication of inspection and supervision found that every foreman in the plant could be made a working foreman. In another instance the resignation of a night watchman brought forth the request from several assistant foremen that they be allowed to alternate in assuming this job rather than accept a contemplated reduction in wages. The adoption of a piece work basis for certain operations previously performed by hourly workers recently effected a reduction in labor cost for a well known textile manufacturer. A short time after the new piece rates had been established the employees, by more efficient work, actually increased the amount of their weekly pay although not without greater effort in the performance of their tasks.

Here again the question of executive bonuses and profit sharing plans comes to the front. It is generally agreed among business men that consideration should be given to recurring cycles in business activity when executive salaries are fixed. If a bonus based on profits is provided to recognize results in periods of prosperity, the management will not be confronted in times of depression with the necessity of reduc-

ing executive salaries with the resultant demoralizing effects.

Inventories

Many business men are coming to the realization that often net profits are due quite as much to inventory turnover as to percentage of mark-up or reasonably low selling costs. Inventory stocks are therefore coming in for critical analysis. In the purchase of raw materials and supplies responsible executives are not only asking the question, "How much stock do we need?" but, "On what day will we need it?" In this connection the proper balancing of inventory stocks becomes of extreme importance. Apart from the certain but somewhat indeterminable cost of obsolescence, carrying charges on surplus inventories greatly exceed the cost of the capital invested in such stocks. An intelligent and systematic planning of production is, of course, a most effective means of keeping inventories at a minimum consistent with the proper administration of the production program.

Manufacturers, it seems, have much to learn from merchandisers, particularly from those in the department store field, with respect to the liquidation of broken lots and surplus inventories. A more general use of the "bargain basement" idea on the part of many manufacturers would do much to keep stocks at economical levels.

Capital Expenditures

While the executive today is giving serious thought to the justification of expenditures, he is also making inquiry as to the return or yield which might reasonably be expected to accrue from such items as capital additions. More than ever new machines and equipment are being purchased on the basis of return through economies in operating costs. This in turn has brought into demand a new kind of costs; costs that reflect individual machine performance and cost of operation. Executives are demanding tangible evidence of savings to support capital expenditures. They are asking plant superintendents to present figures showing the unit or hourly saving expected to be realized in the operation of one machine as against another.

Closely related to the question of fixed asset yield is the practice still followed by some concerns of improperly classifying such items as rehabilitation cost, plant betterments, new appliances and the like. Hiding under the cloak of conservatism some accounting executives in order to effect an immediate saving in federal income taxes have carelessly charged to operating cost items which should properly have been capitalized or charged against a reserve. In justice to some of these executives, it might be said that the decline in recent years of corporate tax rates has lessened their inclination to reduce taxes at the expense of accurate costs. The question of federal taxes has now become of more or less secondary importance.

The effect of this lack of vision in regard to classification of expenditures was recently noted in the sale of an old established business. This concern, a close corporation, had long adopted the policy of expensing items not clearly capital expenditures. Moreover in cases where the company manufactured or improved assets for its own use, its failure to maintain adequate records showing the nature of the work done, made it practically impossible for the accountants to give proper consideration to such additions in their restatement of earnings incident

to the determination of Good Will. Inasmuch as the business was sold for cash, the loss to the stockholders of the old company because of such a policy was substantial.

Sales

In the successfully managed business of today considerable thought is given to the effectiveness of sales expenditures and the possible duplication of distribution costs. Business heads not only insist that a careful study be made of geographical markets but require information concerning the selling cost of each order, the profitableness of an individual customer's business, etc. As a result a separate cost system for the selling division of a business is now coming into more and more use.

As an aid in determining customer trends, analysis of sales by lines of product and type of unit, are finding a more important place in the administration of modern business. This information is reflected in group operating statements showing net profit by lines of product. A careful study of such a statement in one concern recently resulted in a general increase in the prices charged customers for repair and service parts. In this particular case the management felt that necessity for prompt service to meet emergency and irregular demand warranted a price which would assure a normal return on this division of the business.

Waste

In a renewal of efforts to reduce the ever present factor of waste and as a practical deterrent to faulty workmanship, many manufacturing businesses have adopted a system of fines designed to minimize spoilage and defective work. Experience has demonstrated that this restriction encourages better workmanship without increasing the cost of the manufactured product. One superintendent made it his business every morning to inspect the previous day's accumulation of scrap and to ascertain the cause of any consequential instances of spoiled work.

Unprofitable Operations

Where reliable cost records indicate that certain departments of a business are consistently unprofitable their retention becomes a matter for executive consideration. Because of the many factors involved, this question is one which is receiving the attention of many administrative heads. One instance was recently noted where a department showed a repeated loss but a careful study revealed that it carried sufficient fixed overhead to warrant its continued operation. In other words, abandoning that department would have resulted in a greater loss being sustained.

In another case, a concern was renting space in an adjoining building to house certain of its operations. The elimination of a decidedly unprofitable department of the busines and the concentration of manufacturing activities within its own plant resulted in an annual saving in rental of many thousands of dollars. Incidental to the saving in rental, was the more effective supervision made possible through concentration of manufacturing operations.

Method of Control

Of paramount importance in the controlling of expense is the definite placing of responsibility through some form of centralized control. It makes

(Continued on page 19)

Colonel Montgomery Appointed Executive Secretary of War Profit Commission

At its recent session, Congress created the Commission to Take the Profits from War, consisting of four senators, four representatives and six members of the President's cabinet. The first public hearing by the commission was held on March 5th and since that time prominent individuals interested in the problems under consideration by the commissioner have been heard. Among those who have thus far appeared before the commission are Newton D. Baker, Secretary of War during the World War, and Bernard M. Baruch, financier and during the war Chairman of the War Industries Board.

One of the earliest actions by the Commission was the appointment of Colonel Montgomery as its Executive Secretary. His duties are to organize a secretariat for the commission and to direct the intensive research to be made into the economic phases of war as a preliminary to the development of policies which should obtain in the event of war.

The members of our organization will be interested in the War Department's announcement on March 10th of Colonel Montgomery's appointment, which read as follows:

Announcement is made of the appointment of Mr. Robert H. Montgomery as Executive Secretary of the Commission to take the profits from war created by Public Resolution 98, 71st Congress.

Mr. Montgomery by training and experience is peculiarly fitted for this position. He was born in Mahonoy City, Pennsylvania, September 21, 1872, and by profession is a lawyer and accountant. He was partner in the firm of Heins, Whelen, Lybrand and Company, Accountants, from 1896 to 1897, and of Lybrand, Ross Brothers and Montgomery from 1898 to the present time. He was admitted to the bar in Philadelphia in 1902 and in New York in 1904. From 1912 to 1914 he was an instructor in Economics in the School of Business of Columbia University, an assistant professor from 1914 to 1919, professor of Accounting and member of the Administrative Board since 1919 of this school.

During the Spanish-American War he served as a private of Light Battery A, Philadelphia Artillery, Pennsylvania Volunteers, and participated in the Porto Rican Campaign in 1898. From 1898 to 1902 he was a member of the National Guard of Pennsylvania.

He entered the World War as a lieutenant-colonel of the National Army and served as chief of section on Organization and Methods, Office of the Director of Purchases, General Staff, Washington; organized and was a member of the War Department Board of Appraisers; War Department representative on Price Fixing Commission of the War Industries Board; and chief of the Price Fixing Section of Purchase, Storage and Traffic Division of the General Staff. He was honorably discharged in April, 1919.

Mr. Montgomery is a member of the Association of the Bar, City of New York; American Economic Association; American Academy of Political and Social Science; Chamber of Commerce and Merchants' Association of New York; National Tax Association of Pennsylvania; the American Institute of Accountants. He has served as president of the American Association of Public Accountants and of the New York State Society of Certified Public Accountants.

He is the author of the following books: Income Tax Procedure, Excess Profits Tax Procedure, New York State Income Tax Procedure, Auditing Theory and Practice, Auditing Principles, and Financial Handbook.

Mr. Montgomery's present home is Greenwich, Connecticut.

Are Consolidations Profitable?

By J. C. Park, Jr.

(Los Angeles Office)

America worships giants, whether they be athletic, architectural, or industrial. The feeling of antagonism toward "Big Business" ceased with the widespread public ownership of corporate securities. In its place is a certain degree of goodwill supported by a half-accepted belief that large corporations achieve success solely by virtue of their own momentum. Size in corporations is attained most readily and often most efficiently through combining two or more established businesses.

The history of industrial consolidations in the United States shows that the formation of mergers occurs in cycles which quite naturally parallel the business cycles, with greatest activity in periods of prosperity and least during depressions. The immediate impulse to merge is, in the greater proportion of instances, directly traceable to a desire to obtain new capital through a public offering of securities, less easily negotiated when the market for securities is low or declining. Current financial publications report that the consummation of a large number of mergers has been deferred awaiting a more favorable condition of security markets. The present is a period of hesitation and, therefore, an opportune time to consider the profitableness of such combinations as effecting the interests of the companies involved.

It is characteristic of Americans to be optimistic with respect to the future industrial prosperity of this country. This optimism is frequently revealed in the statements of anticipated economies and similar benefits expected from consolidating which are recited in the financing prospectuses issued by merging corporations. Professor Arthur Stone Dewing of Harvard University has inquired into the question whether these predictions are actually fulfilled. He has prepared statistics regarding the earnings of twenty-nine major industrial consolidations effected between the years 1893 and 1902, comparing the earnings subsequent to merging with the previous earnings of the separate companies and with the estimated earnings for the group. From his tabulation, the following conclusions are drawn:

	Number of Consolidations Equaling	
	Previous Earnings	Estimated Earnings
First year	12	4
Tenth year	11	7
Average for 10 yrs.	12	4

The significance of this study is that less than forty-two per cent of the twenty-nine consolidations, selected at random, were able to equal the earnings of the individual units prior to consolidation.

While the future estimates, in some instances, were quite naturally over-optimistic and often impossible of attainment, the fact that the majority of the combined companies were unable to maintain the previous earnings of the individual units may come as somewhat of a surprise. However, the so obvious condemnation of consolida-

tions by statistical data depends on whether the statistics are what they appear to be. Unfortunately, the problem does not permit of a mathematical solution. It is impossible to determine what the operating results of the separate companies would have been had they not been absorbed in the consolidation. Further, the selection of cases is subject to inherent weaknesses.

It is necessary to exclude from consideration those consolidations wherein the merging of ownership was not accompanied by combining of assets and operations and which, therefore, could not avail themselves to the fullest extent of the advantages claimed for consolidations. From a random selection must be eliminated those mergers instigated by personal or other motives not primarily directed toward the economic gain of the companies involved. Finally, a large number of combinations are effected through purchase by a parent company, which, in so far as operating results are considered, have all the characteristics of consolidations but concerning which no statistics are made public.

A detailed review of the purposes of consolidating would consist of a voluminous discussion of the benefits, both concrete and intangible, which are anticipated for the merger as a direct result of the combination. In brief, the purposes generally included some of the following:

1. To obtain economies in:
   (a) Production and overhead costs.
   (d) Distribution costs.
2. To secure market control through:
   (a) A partial or complete monopoly.
   (b) Consolidation of sales efforts previously competitive.
   (c) Reduction of overproduction and anticipation of market trends.
3. To strengthen defenses against external competition.
4. To improve the financial structure.

The advantages of consolidating may be nullified or more than offset by the operation of certain limiting or balancing factors, the human equations, and the fundamental economic law of diminishing returns.

There are four principal factors which ultimately determine the success or failure of a merger. They are (1) personnel, particularly management; (2) economic conditions; (3) financial structure and available capital; and (4) size and type of the combination. Of these four, the first is of paramount importance. To insure the success of a particular consolidation, due consideration must be given all four.

Past history cannot answer whether or not consolidations are profitable; a comparison of earnings may not reveal the whole story. By uniting, hard-pressed companies may often prolong or insure their survival, even though no increased earnings are apparent. Generalizations are of little value. Instances may be cited to prove or disprove almost every imaginable point. Each case, with its own particular set of facts, must be decided on its merits in determining whether consolidation was, or should prove, profitable.

However, in actual practice the possibility of putting together a profitable consolidation is not so much a matter of mere chance as the foregoing remarks might imply. It is a safe assumption that almost every consolidation effects some economies, the profits returned by the ventures depending on whether or not the savings are wiped out by extravagances in other directions. It has been said that future

(*Continued on page* 19)

A Teammate for the Comptroller

By A. R. Philbrick
(Los Angeles Office)

The comptroller and the public accountant already are on remarkably friendly terms. The one, on the inside looking out, and the other, on the outside looking in, are both conscious of steady progress in a common direction to master the figure truths and tendencies of the business they serve. There is an amicable, even fraternal, feeling between them because of a sincere common interest in the aims and pursuits of a profession which has attained the dignity of maturity and the enduring strength of proven worth during the past ten years of American business history.

However, in the majority of instances, the opportunity for professional intercourse between the comptroller and the public accountant is limited to indeterminate periodical contacts. Usually these two come together once or perhaps twice a year during the regular audit, and many diverse matters are likely to be discussed in interviews so short in duration as to make final decisions impracticable. The topics may range from methods of gathering, recording, and stating the financial measurements of the enterprise and the technical, or purely theoretical, phases of certain accounts in use or which should be introduced, to the essential meanings and applications of the facts disclosed by the figure record of past performances.

An interchange of ideas and knowledge is a direct and positive benefit to the client's interests and is of advantage to each participant. It refreshes and stimulates the dormant reflections of the comptroller, beside contributing definitely helpful and valuable additions to his mental stock-in-trade. It is exceptionally rare to find an executive accountant who can truthfully state that the circumscribed methods and meanings of his single business afford him a ready comprehension of many.

To the same extent, the audit advisors of a versatile comptroller are benefited by his opinions, arising as they do from unremitting thought given the demonstrations of applied accountancy in its daily portrayal of the activities of men, materials, machinery, and money. The ramifications of a live, expanding business are constantly presenting the realities of cause and effect to his consideration, and every faculty must be alert and responsive if he is to interpret them adequately as his contribution toward successful administration. The auditor may acquire from the comptroller, and wisely retain, new conceptions of established accounting principles and a deeper insight into modern business practices.

It is, however, admittedly more infrequent than otherwise that the comptroller of the average business enterprise, quite irrespective of its size, can seek the opinions and recommendations which would be available to him were he permitted a sensible freedom in consulting the partners or principals of the firm regularly employed as the auditors of his company. In this respect he seldom enjoys the privileges of professional conference similar to

those open to his superior officers when their responsibilities make it expedient to secure the advice of legal counsel usually retained for such purposes on an annual fee basis.

It is, perhaps, well within the bounds of reasonable surmise to say that few regular audit arrangements with continuing clients contain suitable provision for the intermediate needs for consultative advice upon important matters which arise currently in the affairs of these clients—matters which are preeminently within the domain of accountancy and its allied business economics.

The comptroller who is confronted by the unfamiliar factors of some new situation in his business is occasionally aware that his experience, combined with that of his associates, offers a rather meager solution, instead of the best, of the problem which is pressing for settlement. The references at hand may lack the explicit suggestions and explanations he needs, and there may not be sufficient time to procure and digest the authoritative literature that would supply relief from the difficulties.

The comptroller may possibly have a supplementary plan of accounts in a preparatory or finished state, including necessary procedure instructions and routine forms, designed to meet some prospective change of business policy or an entirely new development already officially authorized. He may be engaged in a general reconstruction of the chart of accounts in order to measure the operations and express the financial position of the business in accordance with up-to-date professional standards. The readjustment of the accounts by the comptroller may be made necessary by diminishing earnings, now being felt by most business concerns, which have aroused a recognition of the crying need to adopt records and accounting improvements that will give a more adequate control of expense, costs, and waste than do existing methods.

The retardant influences now prevailing in all commercial and industrial lines of business have resulted in almost universal recognition of the advantage of budget control. Workable financial programs for the ensuing quarter or half fiscal year are in process of being formulated. Such programs begin with estimates of sales and production, and the attendant outlays for advertising, material or merchandise inventories, labor, new physical facilities, et cetera, and continue through expenses of every nature and class to the final expression of the complete budget program in a projected balance sheet and income statement as at the end of and for the selected period. The serious responsibility and painstaking work of determining the rational expectancies of a business by such means are felt by all its executives, it is true, but the weight of the burden is carried by the comptroller and his assistants.

The studious deliberations of both public and executive accountants are constantly engaged by questions arising from the great body of fundamentals and the minutia of fact and method upon which progressive American business organizations are building success.

Whatever the problem, and apart from the realization that some elusive principle should be ascertained or some group of complex conditions correctly assayed, the comptroller appreciates the advantages to be gained by submitting his problems and solutions

(*Continued on page* 19)

"As Inevitable as Death and Taxes"

By Earl Van Wagoner
(Los Angeles Office)

The above title represents what has become, in a sense, a national slogan. It is probably correct to say that the well versed tax counselor is the only person who refuses to concede the general inevitableness of taxes, particularly federal or state income taxes. His experience and knowledge of tax laws give him excellent reasons for insisting that in a very large number of cases so-called "inevitable" taxes are actually economic penalties self-imposed by taxpayers who failed to consider, in due time, ways and means of avoiding such taxes. That which can be avoided certainly is not inevitable.

Many taxpayers have shied away from consideration of ways and means of avoiding taxes because of a fear of being accused of illegal or unethical practices. Others have merely overlooked the possibilities for tax savings. Neither need have suffered had he employed competent tax counsel.

As Colonel Montgomery has said in his 1929 Federal Tax Practice:

> "It is not illegal to legally avoid paying tax; it does not even involve moral turpitude. When tax rates are oppressive and unscientific, the instinct of self-preservation asserts itself strongly."

It has long been well established that the courts will resolve doubtful points in favor of the taxpayer and against the government. Accordingly, a taxpayer who has availed himself of his legal right to so handle his transactions as to incur only the minimum tax or to avoid tax entirely will be upheld by the courts. The test which his procedure will have to stand is that laid down by Mr. Justice Holmes in Horning v. District of Columbia (254 U. S. 135), where, in upholding a taxpayer charged with fraud and tax evasion, the court said:

> "It may be assumed that he intended not to break the law, but only to get as near to the line as he could, *which he had a right to do;* but if the conduct described crossed the line, the fact that he desired to keep within it will not help him. It means only that he misconceived the law."

If it is legal for a taxpayer to reduce or avoid taxes by proper means, there certainly is nothing illegal or fraudulent in employing competent counsel to assist by prescribing the proper legal methods of accomplishing the desired end.

As an example of a case where true avoidance was upheld, reference is made to Weeks v. Sibley (269 Fed. 155). In this case the individuals controlling the affairs of an association or joint stock company taxable as an association sought a method of avoiding or lessening taxes on future profits. They dissolved the company and transferred all of the assets under a trust agreement to a trust which under Section 219 of the Revenue Act of 1918 was not taxable as an entity because its income was "to be distributed to the beneficiaries periodically whether or not at regular intervals." The property (oil land) was thereafter sold for a consideration consisting of $475,-000 in cash and $593,750 to be paid from a certain percentage of oil produced.

The Bureau of Internal Revenue contended that the change to the trust was a sham and a subterfuge and ineffective to prevent taxation of the profit to the former organization as a corporation. The court said in part:

> "It is the opinion of this court that the right to change the status of an organization, or to dissolve an organization in any legal manner, is not made ineffectual because the motive impelling the change is to reduce or avoid taxation in the future. The right so to do is an incidental right, inseparably connected with an individual's right to own and control his property. It is practically identical with the sale by a citizen of tax-burdened securities and the investment of the proceeds thereof in tax-exempt ones, for the purpose of reducing or avoiding taxation."

In the foregoing case it is clear that a material tax saving must have been effected because of the difference in the tax rate on corporations and the normal tax on individuals. Under the old form of organization, the income was first taxed to the association at corporation rates, and dividends distributed to the stockholders were subject to surtax rates. Under the new form, only the normal and surtax on individuals were payable. A similar reduction under the 1928 act would result certainly in a saving of at least the difference between the 12 per cent corporation rate and the 5 per cent maximum normal tax on individuals. Failure to have rearranged their business affairs in this instance would have resulted in the interested parties paying an economic penalty of the amount of the possible saving.

Frequently it is highly desirable in the case of small close corporations to change to the partnership form of doing business because of the material tax saving possible. Accordingly, in the case of individuals embarking in a new business, the selection of the corporate form over the partnership form may subject the interested parties to a severe economic penalty through the resultant corporation income tax.

As a simple example, consider four married men with two children each (and no other deductions) organizing a new corporation which will show a net profit for the year of $20,000. This corporation would pay a tax of 12% of $17,000 ($20,000 less $3,000 exemption), or $2,040, as against an aggregate of individual income taxes under an equal partnership form of less than $100.

Again we have a common situation where stockholders of a corporation acquiesce in the sale of its assets to another corporation for cash. If the sale is made directly by the first corporation it will be subject to a tax at 12% on its profit on the sale, and its stockholders receiving a cash distribution in liquidation will be taxed again on the net distribution at normal and surtax rates, or at the 12½% capital gains rate, if they have held the stock over two years and elect to be so taxed.

Clearly the corporation tax can be entirely avoided and a material saving to the stockholders effected if a distribution in liquidation of all the assets of the corporation is made to its stockholders or for their benefit to trustees appointed by them and the assets immediately thereafter sold *by the stockholders or trustees* to the second corporation. A contract to sell may be executed by the stockholders in such a case before the actual distribution in liquidation. Failure to take advantage of this right to avoid or save taxes is self-imposition of a severe economic penalty.

The right of stockholders to avoid taxes in this manner was specifically upheld by the U. S. Board of Tax Ap-

peals in the Appeal of Robert Jemison, Jr., et als., 3 B. T. A. 780. Again in Taylor Oil & Gas Co., 15 B. T. A. 609, the Board of Tax Appeals said:

"We have not been influenced by the fact that this case arises from an admitted and avowed attempt to escape taxation as a corporation. While, in the face of such avowal, it is the duty of this Board to look to the substance, it would be our duty as well to uphold the taxpayer in such an attempt if lawfully devised and in effect successful."

In this latter case the Board had to decide against the taxpayers because the methods used were not effective due to the wording of certain instruments executed and the provisions of certain state statutes relating to dissolution of corporations. Had arrangements been made to liquidate all debts and satisfy creditors' claims before dissolution and had all the instruments involved been more carefully drawn, with the state law in mind, to reflect a sale by the stockholders of assets received by them in liquidation, it appears that the Board would have found for the taxpayers.

Frequently individuals having large incomes make sales of property involving appreciable profits. Since these profits add to the other income they are in actuality subjected to the highest rates of tax. These excessive taxes can generally be avoided by taking advantage of the installment sales provisions of the law, which permit the income to be reported over a period of years if properly handled. Such a taxpayer cannot properly complain of excessive taxes if, through his own fault and failure to secure proper advice, he loses the benefit of legal methods of avoiding them.

The foregoing are a few typical or common instances showing how taxpayers have opportunities to avoid paying excessive taxes. They do not purport to embrace any material portion of the ways and means open to taxpayers in various transactions. Competent tax counsel can suggest innumerable other methods under various sets of facts. Therefore, taxpayers who refuse or fail to consult competent tax counsel before carrying out proposed transactions should not be heard to complain of excessive taxes levied by Congress. They should complain rather of the self-imposed economic penalties constituting a material part of their tax burden.

In conclusion it appears desirable to define what is embraced in the term *consulting* competent counsel used in this article. It should be understood that this does not mean that taxpayers should submit hypothetical cases to tax counsel and then proceed to make their own adoption of counsel's opinion to a different set of facts.

When tax matters are to be considered it is necessary that *all facts* accomplished or procedure conceived desirable be fully disclosed to the tax counsel. It is equally important that all steps thereafter taken should be supervised and approved by the tax counsel. Regardless of whether the question be one of formation, rearrangement, or dissolution of a business, corporate or otherwise, or any of the other innumerable transactions involving federal income tax, a free and full discussion of any and all matters related thereto cannot help but pay the taxpayer dividends in tax savings and freedom from worry. Macaulay, in recognition of the importance of such free discussion, said, "Men are never so likely to settle a question rightly as when they discuss it freely."

On the old theory that a penny saved is a penny earned all taxpayers owe

(*Continued on page* 20)

Claude F. Griffis

It is with extreme sorrow that we report the death of Claude F. Griffis on February 17, 1931. "Grif", as his many friends of the New York office learned to call him, was born in Binghamton, New York, October 9, 1888. He graduated from Hamilton College in 1909 and after a brief commercial business experience, joined the staff of L. R. B. & M. on December 23, 1912. While a member of the staff he studied nights at New York University and obtained his degree from that college in 1914. With the exception of the two occasions mentioned below, he was connected with our firm until his death. The only breaks in this long service were for the period of the World War, during which he served as a second lieutenant connected with air service production, and a period of two years during which he was general auditor of one of our clients.

Beginning as a junior accountant with our firm at a time when the New York office staff was much smaller than it is now, he became in time one of our principal seniors, due to a combination of ability and industry. During this long period of years his experience was varied and he showed himself capable of carrying to a successful completion any work assigned to him.

Those who knew him intimately found him to have a pleasing personality, even under the most trying times during rush periods. The partners recognized him as an industrious, reliable, painstaking accountant. "Grif" always placed the interests of the firm above his personal interests, with the natural result that all of the clients for whom he worked held him in the highest esteem.

He passed the New York C.P.A. examination in June, 1914, was a member of the New York State Society of Certified Public Accountants and of

(*Continued on page* 20)

The L. R. B. & M. Journal

Published by Lybrand, Ross Bros. and Montgomery, for free distribution to members and employees of the firm.

The purpose of this journal is to communicate to every member of the staff and office plans and accomplishments of the firm; to provide a medium for the exchange of suggestions and ideas for improvements; to encourage and maintain a proper spirit of cooperation and interest and to help in the solution of common problems.

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An Acknowledgment To Los Angeles Office

For this issue the L. R. B. & M. Journal is especially indebted to our Los Angeles office. A majority of the articles herein were written by members of the staff of that office. It is suggested to our other offices that they "go and do likewise."

Partners' Activities

At the meeting of the New York State Society of Certified Public Accountants held at the Hotel Pennsylvania on November 24, 1930, Colonel Montgomery, as Chairman of the Committee on Cooperation with Bankers and Other Credit Grantors, conducted the meeting. He presented for discussion points to which every practicing accountant should pay particular attention so that they may not be overlooked in the preparation of financial statements. After Colonel Montgomery's informal talk the rest of the meeting was taken up in a discussion of questions which arose at the October 8th meeting of the Robert Morris Associates attended by the Society's special Committee on Cooper-

ation with Bankers and Other Credit Grantors of which he is Chairman.

On December 9th the New York Chapter of the Robert Morris Associates invited Colonel Motgomery's committee to be their guests at a dinner meeting held at the Harvard Club. The purpose of this meeting was to continue the discussion started at the Briarcliff meeting on October 28th.

On December 15th Colonel Montgomery was the guest speaker at a forum meeting of the New York Credit Men's Association. His subject was "The Liability of an Accountant." The address was informal and was followed by a general discussion. The meeting was very successful and much interest was shown in the subject.

At the December meeting of the New York State Society of Certified Public Accountants the members of the Practice Procedure Committee presented various subjects for discussion. Mr. Staub as a member of that committee spoke on "Some Tax Aspects of Inventories." His remarks formed an article in the Society's January Bulletin. Since the first of the year Mr. Staub has spoken on federal income taxation on the following occasions: At a meeting of the New York State Society of Certified Public Accountants on January 12th, when he divided the program with Doctor J. J. Klein; at a dinner meeting of the Hartford Chapter of the National Association of Cost Accountants at the Elm Tree Inn in Farmington, Conn., on January 20th; and at a technical meeting of the Accountants Club on February 26th.

Mr. Sweet has been appointed chairman of a committee of the Boston Chamber of Commerce to inquire into the facts concerning savings bank life insurance in Massachusetts.

Staff Meetings

Meetings of the staff, and particularly of the seniors who have the primary responsibility for the conduct of the field work on engagements, are held from time to time at various of our offices. Two meetings which were held especially to prepare for the large number of audits to be made during January and February, were those at the New York and Boston offices.

At New York the staff get-together took the form of an informal dinner at the Drug and Chemical Club on December 17th. After dinner Mr. Lybrand, in an interesting talk, pointed out a number of special accounting features that should receive careful consideration in view of present conditions.

Following Mr. Lybrand, Mr. Staub answered various questions asked by those present, either in elaboration of the statements made by Mr. Lybrand or to clarify accounting or tax questions of particular interest to the inquirer.

The meeting was voted a great success by all attending. There can be no doubt that gatherings of this character go a long way toward helping the members of the staff in the solution of common problems. Especially is this so in times of stress such as those through which we are now passing.

A meeting of the Boston staff was held on December 16, 1930 for the purpose of considering some of the many special problems likely to arise in

1930 audits, particularly in view of business conditions during the year. Some clients may desire to minimize disappointing operating results by changes in accounting policy. Defalcations are more frequent in periods of business depression.

The key to the problem was stated to be in preparedness for more efficient work through improved organization and methods. Preparation of audit programs and instruction of assistants should be accomplished in advance. Important questions requiring study and discussion with the client should be developed as early in the engagement as possible by endeavoring to obtain a general view of the accounts before proceeding with the details of the audit. Text of reports should be written as the work progresses while the particular subject matter is clearly in mind. Wherever possible, the assistance of the client's staff should be utilized in assembling data for our more ready use.

There was discussion of means to strengthen the technique of cash verification in order to bring to light possible defalcations even on engagements to make balance sheet audits. The extent to which income should be verified in balance sheet audits was also discussed.

It was pointed out that constructive suggestions made by us are of great help in demonstrating the practical value of our auditing work. Staff members were urged to bear this constantly in mind during the progress of audits and to remember that such suggestions frequently lead to more work for the office during the summer.

The latter part of the meeting was given over to consideration of specific points relating to current audits, including the following:

Liability certificates.
Purchase and sales commitments.
Confirmation of accounts receivable.
Valuation of inventories.
Relation of maintenance and depreciation.
Surprise verifications of petty cash bonds.

Other offices have also had such meetings but details thereof are not in hand at the time of going to press.

Notes

Mr. Warren, who is in charge of our Cleveland office, has been elected president of the Cleveland Chapter of the Ohio Society of Certified Public Accountants. He has also been appointed a member of the Legislative Committee of the State Society.

S. B. Ives, who is in charge of our Atlanta office, which was opened last fall, passed the Georgia State Board of Accountancy examination.

Lester F. Blake of the Boston staff delivered a talk to the Providence, R. I., chapter of the National Association of Cost Accountants on the subject "Control of Operations and Finance Through Budgets."

The leading article in the January issue of the *Commercial and Financial Digest*, published in Los Angeles, was written by Edwin B. Cassidy of our office in that city, and was entitled the "Professional Accountant and the California Corporate Securities Act."

At a meeting of the Massachusetts Society of Certified Public Accountants, C. A. Bader of the Boston staff was one of four members of the Society to speak on the subject of cash audits and detection of defalcations.

M. Ochis, a member of our Detroit staff, passed the November C.P.A. examination in Michigan.

Varying Annuities and Their Application

By J. McCullough
(New York Office)

Sprague and Perrine in their "Accountancy of Investment" at paragraph 82 state,

"There may also be varying annuities, where the instalment changes by some uniform law. These seldom occur in practice. Where the change is simple, as in arithmetic progression, the total annuity may be regarded as the sum of several partial annuities; otherwise the values must be separately calculated for each term. An annuity running for five terms, as follows; 13, 18, 23, 28, 33 may be regarded as the sum of the following:

(1) An annuity of 13 for five terms.
(2) An annuity of 5 for four terms.
(3) An annuity of 5 for three terms.
(4) An annuity of 5 for two terms.
(5) An annuity of 5 for one term.

In actual practice, in a case of this kind, in order to find the amount or present worth of the annuity, it would probably be easiest to find the amount or the present worth of each term and then find the total of these items."

The procedure suggested by the authors as easiest to follow, is evidently very laborious where the annuity runs for a considerable length of time. In fact, formulae are available which enable one to obtain with little effort the sum or present worth of varying annuities not only of the type illustrated by the authors but even of more complex nature. Since these formulae are not set forth in books on mathematics of finance which are usually available and since problems have arisen in practice where such formulae were very useful, it was felt that their presentation and illustration here would perhaps prove of some value when similar problems arise in the future.

A — Sum of varying annuity — where the series is an arithmetic progression.

This annuity is of the type mentioned by Sprague and Perrine and may be illustrated as follows:

End of Period	Amount
1	\$500
2	525
3	550
4	575
5	600

It is required to find the sum of this annuity at the end of n periods where each instalment is invested at i per cent. per period.

The sum of such an annuity is given by

$$S = Cs_n + \frac{D}{i}(s_n - n)$$

In this formula,

S = Sum
C = First instalment
D = Difference between each instalment
i = Rate of interest
s_n = Amount of ordinary annuity of 1 for n periods at the rate of i per cent. per period
n = The number of periods

s_n is given for many periods and rates in such manuals as Glover's "Tables of Applied Mathematics in Finance, Insurance and Statistics."

Thus, if the rate is 5 per cent. the values of all the terms set forth in the foregoing formula are

$C = \$500$
$s_n = 5.52563125$
$D = \$25$

$i = .05$
$n = 5$
$S = \$3025.63$

If the instalments decreased D would be a negative quantity. Thus, in the instant problem, if the second instalment were \$475, D would equal —25.

B—Present worth of varying annuity—where the series is an arithmetic progression.

This annuity is of the same type as that illustrated under A, except that in this problem the present worth of the annuity is required. If M is the required present value, the formula would be $M = Ca_n + \frac{D}{i}(a_n - nv^n)$

In this formula

$M =$ Present worth
$C =$ First instalment
$D =$ Difference between each instalment
$i =$ Rate of interest
$n =$ The number of periods
$a_n =$ Present worth of ordinary annuity of 1 for n periods at the rate of i per cent. per period
$v^n =$ Present worth of 1 due n periods hence at the rate of i per cent. per period

a_n and v^n are also given for many periods and rates in manuals on mathematics of finance.

Thus, if the rate is 5 per cent., the values of all the terms set forth in this formula are

$C = \$500$
$a_n = 4.32947667$
$D = \$25$
$i = .05$
$n = 5$
$v^n = .78352617$
$M = \$2370.66$

C—Sum of varying annuity—where the series is a geometric progression.

In this type of annuity, the quotient obtained by the division of any two adjacent instalments is constant. It may be illustrated as follows:

End of Period	Amount
1	\$500
2	1,000
3	2,000
4	4,000
5	8,000

It is required to find the sum of this annuity at the end of n periods where each instalment is invested at i per cent. per period.

The sum of such an annuity is given by

$$S = C\left(\frac{r^n - q^n}{r - q}\right)$$

In this formula

$S =$ Sum
$C =$ First instalment
$r =$ Ratio of an instalment to preceding one
$q =$ The rate of interest increased by unity. That is, it is equal to $1 + i$, where i is the rate of interest
$n =$ The number of periods

The values of $(1 + i)^n$ or q^n are also given for many periods and rates.

Thus, if the rate is 5 per cent., the values of all the terms set forth in the foregoing formula are

$C = \$500$
$r = 2$
$q = 1.05$
$n = 5$
$r^n = 32$
$q^n = 1.27628156$
$S = \$16,170.38$

D—Present worth of varying annuity—where the series is a geometric progression.

This annuity is of the same type as that illustrated under C except that in this problem the present worth of the annuity is required. If M is the required present worth, the formula would be

$$M = C\left(\frac{r^n v^n - 1}{r - q}\right)$$

$M =$ Present worth
$C =$ First instalment
$r =$ Ratio of an instalment to preceding one

q = The rate of interest increased by unity. That is, it is equal to $1 + i$, where i is the rate of interest per period

n = The number of periods

v^n = The present worth of \$1 due n periods hence at the rate of i per cent. per period

Thus, if the rate is 5 per cent. the values of all the terms set forth in the foregoing formula are

$C = \$500$
$r = 2$
$q = 1.05$
$n = 5$
$r_n = 32$
$v^n = .78352617$
$M = \$12,669.92$

E—Sum of varying annuity—where first differences form an arithmetic progression.

In this type of annuity, if the differences between each instalment be arranged in a column, they will form an arithmetic progression. It may be illustrated as follows:

End of Period	Amount	First Differences
1	\$3,000	
2	2,700	\$300
3	2,370	330
4	2,010	360
5	1,620	390

It is required to find the sum of this annuity at the end of n periods where each instalment is invested at i per cent. per period.

The sum of such an annuity is given by

$$S = Cs_n - \left[\frac{s_n - n}{i}\right]\left[D + \frac{F}{i}\right] + \frac{F\,n\,(n-1)}{2i}$$

In this formula

S = Sum

C = First instalment

i = Rate of interest

n = Number of periods

D = The difference between the first two instalments

F = The difference between two adjacent differences

s_n = Amount of ordinary annuity of 1 per n periods at the rate of i per cent. per period

Thus, if the rate is 5 per cent., the values of all the terms set forth in the foregoing formula are

$C = \$3,000$
$i = .05$
$n = 5$
$D = \$300$
$F = \$30$
$s_n = 5.52563125$
$S = 13,115.53$

F—Present worth of varying annuity—where first differences form an arithmetic progression.

This annuity is the same as that illustrated under E, except that in this problem, the present worth of the annuity is required. If M is the required present worth, the formula would be

$$M = C\,a_n - \left[\frac{a_n - v^n n}{i}\right]\left[D + \frac{F}{i}\right] + \frac{v^n F\,n\,(n-1)}{2i}$$

M = Present worth

C = First instalment

v^n = The present worth of \$1 due n periods hence at the rate of i per cent. per period

a_n = The present worth of an ordinary annuity of \$1 for n periods at the rate of i per cent. per period

n = The number of periods

i = The rate of interest

D = The difference between the first two instalments

F = The difference between two adjacent differences

Thus, if the rate is 5 per cent. the values of all the terms set forth in the foregoing formula are

$C = \$3,000$
$v^n = .78352617$
$a_n = 4.32947667$
$n = 5$
$i = .05$
$D = \$300$
$F = \$30$
$M = \$10,276.36$

These formulae find their practical application in the solutions of problems involving the redemption of a serial issue by a sinking fund.

Thus, let us suppose that a company wished to know what annual payment

(*Continued on page 20*)

EXECUTIVE CONTROL AS APPLIED TO COST REDUCTION

(*Continued from page* 3)

little difference what kind of expenditures the executive wishes to regulate, whether they be sales, purchases, production, expense, plant additions or what not, the Budget is generally recognized as the most practical means of accomplishing systematic control. An effective Budget plan regulates the spending of money and it is in periods of declining earnings that executives truly realize the importance of accurately measuring results obtained from expenditures.

Making Use of Present Opportunities

Executives everywhere are availing themselves of the opportunity presented during periods of curtailed production to make needed refinements in their cost and production control systems. Changes made at such a time make use of certain available administrative workers and result in a minimum of disruption of regular work. Other organizations are renewing their efforts to provide adequate methods of internal check with respect to accounting records, methods and details. Certain of the shop employees are frequently used to clean and paint the plant while others assist in the rehabilitation of machinery and equipment.

In times of business decline, the ground work is laid for periods of prosperity which inevitably follow.

ARE CONSOLIDATIONS PROFITABLE?

(*Continued from page* 6)

consolidations will be directed toward facilitating and reducing the costs of distribution and that future mergers will be of the horizontal and circular types (combining similar functions in the production or distribution of competitive or allied products) rather than the more familiar vertical type of combination which links up the chain from raw material to finished product. While this statement may be true in so far as it applies to the large corporations, particularly those originating in earlier consolidations, which may have attained the utmost in operating efficiency, the field is still open to their smaller competitors and to such new industries as are continually springing up as the result of new developments in science and invention.

One of the purposes for which a consolidation may be formed is to enable the several units to maintain their ground more successfully in the face of increasing external competition and other economic stringencies. This is a defensive measure solely, but one of growing importance. While the presence of powerful competitors in the field of business often makes a merger of this type imperative, the very existence of this competition makes for a more healthy business condition. The time appears to be ripe for the smaller consolidation; and, whereas the objectives of earlier consolidations have been centered around quasi-monopolistic profits, the smaller combinations of the future will be conceived in the more conservative policy of a lesser but more certain return derived through the application of proven methods in stabilized markets.

A TEAMMATE FOR THE COMPTROLLER

(*Continued from page* 8)

for review by professional consultants whose broader business contacts and technical experience have equipped

them to render him advice and assistance.

A free hand to arrange at will for conferences with his auditors would permit the comptroller to avail himself of the benefits of the special and collective experience thus made available. The quality and timeliness of the advice and not the apparent cost should be the deciding factor when considered in relation to profitable management. Able and timely advice may become the ounce of prevention that saves the pound of cure.

"AS INEVITABLE AS DEATH AND TAXES"

(*Continued from page* 11)

themselves a duty to proceed on the basis of competent advice from recognized tax counsel. Men who consult bankers about their finances, lawyers about purely legal matters, accountants about accounting matters, and physicians and surgeons about their health should no longer hesitate in the matter of consulting tax counsel on all business transactions which may involve federal income taxes or similar state taxes. He who refuses to recognize opportunity for saving has no just complaint against the natural results of his own delinquency.

CLAUDE F. GRIFFIS

(*Continued from page* 12)

the American Institute of Accountants. As a diversion, tennis appealed to him and he played a good game.

Interment was from his late home in Roslyn, Long Island. He is survived by his widow, Gladys E. Griffis, and his two children, Jay Warren, seven, and Jane Ann, five and one-half years old.

VARYING ANNUITIES AND THEIR APPLICATION

(*Continued from page* 18)

when invested at 5 per cent. would be sufficient to retire a $100,000 bond issue with interest in the following annual instalments, first, $10,000; second, $15,000; third, $20,000; fourth, $25,000; and fifth, $30,000.

The following table shows what annual payments must be made from the sinking fund to meet both interest and principal. The difference columns (4) and (5) indicate the type of annuity involved.

(1) Principal	(2) Interest	(3) Total	(4) First Differences	(5) Second Differences
$ 10,000	$ 5,000	$ 15,000		
15,000	4,500	19,500	4,500	
20,000	3,750	23,750	4,250	250
25,000	2,750	27,750	4,000	250
30,000	1,500	31,500	3,750	250
$100,000	$17,500	$117,500		

The problem, therefore, resolves itself into the determination of what annuity would equal that shown under column (3). It is evident that it corresponds with E.

In this instance

$$C = \$15{,}000$$
$$i = .05$$
$$n = 5$$
$$D = -\$4{,}500$$
$$F = +\$250$$
$$s_n = 5.52563125$$

If I represents the required sinking fund instalment, it is evident that

$$I\,s_n = C\,s_n - \left[\frac{s_n - n}{i}\right]\left[D + \frac{F}{i}\right] + \frac{F\,n\,(n-1)}{2i}$$

$$I = C - \left[\frac{s_n - n}{i\,s_n}\right]\left[D + \frac{F}{i}\right] + \frac{F\,n\,(n-1)}{2i\,s_n}$$

$$I = \$23{,}097.48$$